CHAPTER 4

FLUID MILK MARKET AND PROMOTION ASSESSMENT

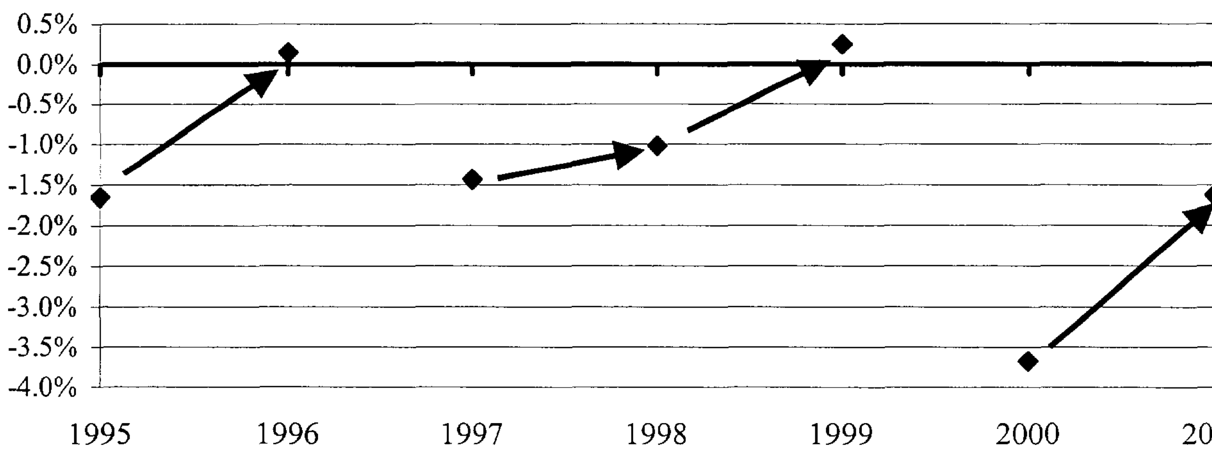
For the third consecutive year, Beverage Marketing Corporation (BMC) has been commissioned by dairy Management Inc. and the Fluid Milk Processor Promotion Board to review the generic fluid milk advertising and promotional programs. This review offers a subjective evaluation of the effectiveness of those programs. BMC evaluates milk's position relative to milk's competitive beverage set — its respective marketing efforts and market performance. BMC believes milk's competitive set includes most non-alcoholic refreshment beverages, specifically carbonated soft drinks, bottled water, fruit beverages, ready-to-drink teas, and sports beverages. This year BMC examines both the overall milk industry's performance as well as the effect that targeted advertising and promotion have had on milk consumption by the crucial demographic cohorts. The following summarizes our findings based on the analysis of available data.

BMC'S ASSESSMENT OF CURRENT MILK INDUSTRY ENVIRONMENT

Total fluid milk consumption/volume has moved up and down within a narrow range of small declines and gains over the past 30 years. Over the past decade, total volume has been essentially flat, while per capita consumption has slid downward. However, since 1995, the rate of decline in fluid milk consumption has actually decreased in four out of the last six years in year-over-year comparisons. See **Figure 4-1**. BMC believes that fluid milk volume declines would have been greater without the impact of the national generic fluid milk advertising and promotional program. Additionally, targeted marketing to key demographics such as kids, teens and Hispanics by the national generic program has been effective in increasing consumption among these key targets.

Figure 4-1

Per Capita Consumption Percentage Change
1995 - 2001



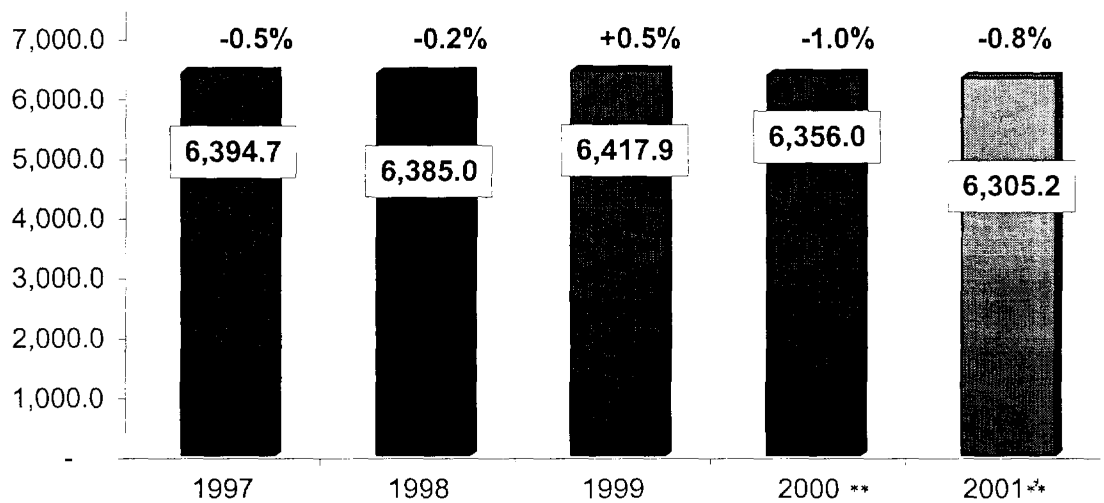
Source: Beverage Marketing Corp., USDA

The history of volume changes for fluid milk sales over the past five years is shown in **Figure 4-2**. Milk's compound annual growth rate (CAGR) was -0.3% from 1997 to 2001. Milk volume in 2001 shrank 0.8% to 6,305.2 million gallons. Along with the decline in volume, per capita milk consumption dropped 1.8% to 22.2 gallons per capita in 2001.

Note: In past years, BMC relied largely on retail scanner data as the basis for milk volume/growth analysis. BMC's milk data (based largely on scanner data) agrees directionally with the USDA data and shows milk volume down in 2001. For 2001, USDA data are being used. To make an accurate point of comparison, 2000 has been restated to be consistent with the USDA while data from 1997-1999 were already consistent with USDA figures.

Figure 4-2

Fluid Milk Sales Volume* and Growth
1997 – 2001



Per Capita Consumption(r)	**23.6**	**23.2**	**23.1**	**22.5**	**22.2**

* In millions of gallons; ** Based on USDA milk data
r = Revised
Source: Beverage Marketing Corp.; USDA

The data of **Figure 4-3** compares the per capita consumption performance of milk with its competitive set. Milk ranks second in per capita consumption within its competitive set. All competitive beverages outperformed milk in 2001 and with the exception of carbonated soft drinks all had positive per capita growth.

Figure 4-3

Per Capita Consumption Gallons & Change 2000-2001

	2000	2001	Change
CSD	55.6	55.3	-0.5%
Milk (r)	22.5	22.2	-1.8%
Bottled Water	18.3	20.1	9.8%
Fruit Beverages	15.3	15.5	1.3%
Sports Drinks	2.7	2.8	3.7%
RTD Tea	1.8	1.9	5.6%

Source: Beverage Marketing Corp.; USDA
r= Revised

As shown in **Figure 4-4**, the total competitive beverage set, including milk, grew at a CAGR of 1.8% from 1997 to 2001. Without milk, competitive set volume would have risen at a CAGR of 2.3% in the same period. It is interesting to note that the competitive set would have grown at a CAGR of just 0.84% from 1997 to 2001 if bottled water were excluded.

Figure 4-4

Volume Growth of Milk and Its Competitive Set 1997-2001

	Milk	Total Competitive Set	Comp. Set w/o Milk	Comp. Set w/o Water
1997	-0.5%	2.9%	3.9%	2.0%
1998	-0.2%	3.4%	4.3%	2.4%
1999	0.5%	2.5%	3.0%	1.0%
2000	-1.0%	1.2%	1.7%	0.5%
2001*	-0.8%	1.9%	2.6%	0.3%
97-01 CAGR	**-0.3%**	**1.8%**	**2.3%**	**0.8%**

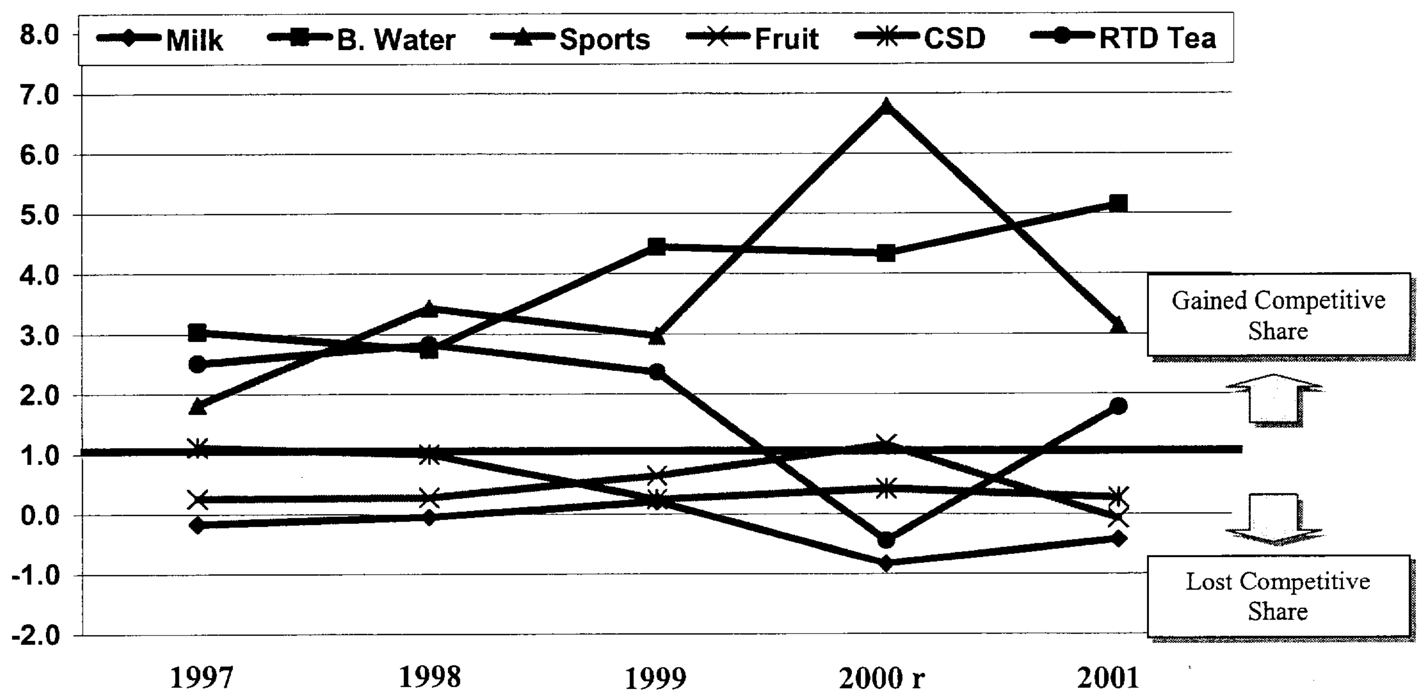
Source: Beverage Marketing Corp.; USDA

BMC analyzed milk's annual share of the volume increase of the entire competitive set over the past 15 years. This measure of milk's performance is an index based on its share of competitive volume change, divided by milk's market share of the competitive set at the beginning of the year. When this index is greater than 1, milk is improving its share. When less than 1, milk's share of the competitive set is declining. Milk's share of competitive turnover from 1997 to 2001 is shown in **Figure 4-5**, along with data for the competitive set. From 1997 to 1999, milk had shown improvement in competitive turnover rates, though still losing share to competitors.

Milk's share of competitive turnover declined the last two years, though its index recovered slightly from restated 2000 (-0.8) to –0.4 in 2001. Bottled water was once again the strongest performer of the competitive set, with a share of competitive turnover index of 5.1 in 2001. Sports beverages followed at a distant 3.1.

Figure 4-5

Milk Indexed Share of Competitive Turnover
1997 - 2001

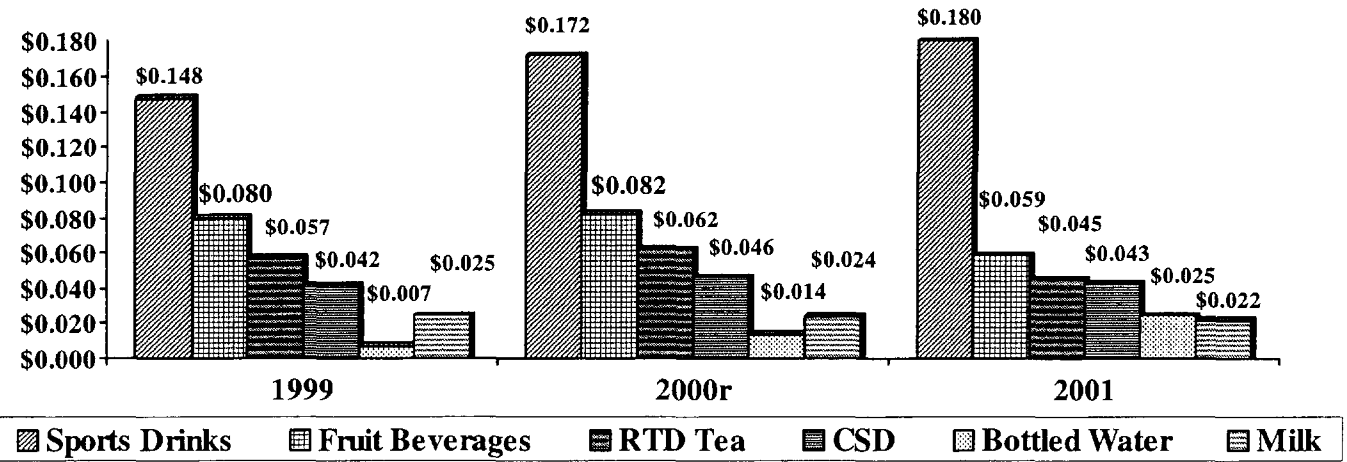


Source: Beverage Marketing Corp.; USDA
r: Revised

Milk's competitive environment remains one of the most challenging in beverage history. Recent years have seen the increasing breadth and strength of major beverage brands, especially in the bottled water business, which raised the level of competition for consumers' minds and dollars. Importantly, marketing and advertising efforts of the competitive set have continued to climb significantly in all categories. See **Figure 4-6**.

Figure 4-6

Competitive Set Advertising Spend per Gallon
1999 - 2001



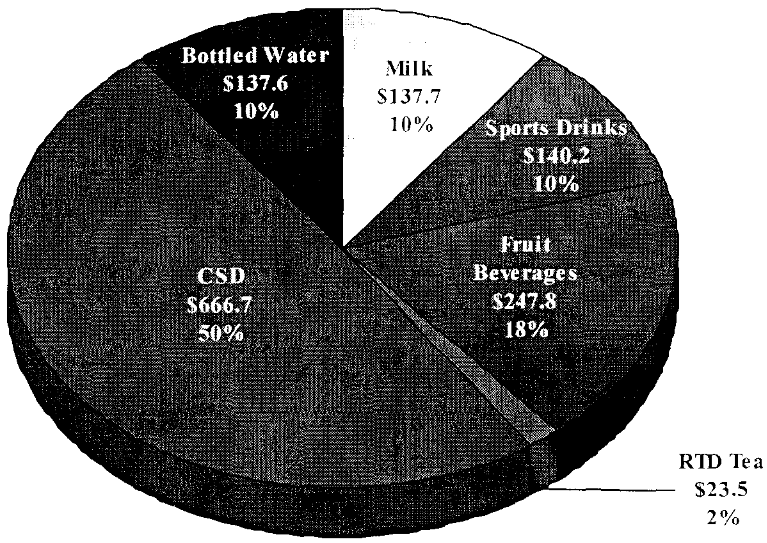
Source: Beverage Marketing Corp.; USDA; CMR Multimedia Service

In 2001, at $0.022 per gallon, milk spent the least on advertising per gallon of any of its competitors, nearly three tenths of a cent less than its nearest competitor, bottled water, at $0.025 per gallon. In 2001, $137.7 million was spent on milk advertising. While most of that spending came from the national generic fluid milk program, some of it came from individual processors. Again in 2001, carbonated soft drinks accounted for essentially half of all advertising spending of the competitive set. See **Figure 4-7**.

Quantitative analysis of competitive beverages' promotional expenditure is impossible because the data are kept confidential. However, BMC believes that milk is overspent by the competitive set to an even greater degree on promotion and other marketing programs than it is on advertising. This competitive mismatch is undoubtedly a key contributor to milk's flat sales performance.

Figure 4-7

Competitive Set Advertising Spending
2001
(Millions of Dollars)



Source: Beverage Marketing Corp.; CMR Multimedia Service

Milk remains at a competitive disadvantage in several important respects:

Consumer attention

- An increasing array of non-milk beverage products are competing for the attention of the consumer. Many have co-opted milk's product attributes, such as a source of calcium.
- Reduced share of voice due to decreases in milk advertising spending and increases in competitive spending.

Product attributes and innovation

- While milk has begun to innovate, it still lags behind almost every other category in the competitive set in this respect. Milk still offers limited new products and flavors in comparison to the competition.
- Milk consumption in single-serve plastic packages was up more than 4% in 2001 based on limited IRI data, and likely grew more than that if convenience store data were included. Plastic single-serve is likely to become milk's most important innovation in terms of brand, product, image improvement and channel availability as food service, vending, and other channels develop.

Branding

- Milk's competitive set is dominated by world-class marketing organizations with powerful brands. Milk has only a handful of large brands and is still largely viewed as a commodity.
- The majority of milk volume is private label, while just a fraction of the competitive set is accounted for by private label. This lack of strong milk brands continues to hamper milk's ability to compete, as we believe branded product advertising is more effective than generic advertising in the beverage industry.
- Consolidation in the dairy industry should lead to brand development and innovation, but has yet to yield significant brand marketing gains.

Distribution

- Despite milk's inroads into fast-growing, non-traditional channels, including vending, quick-serve (e.g., Dunkin' Donuts), and mass merchandisers (e.g., Wal-Mart), milk remains a primarily supermarket-purchased, take-home product.
- Milk vending is likely to become an important channel for processors, and has the potential to improve the availability, merchandising, and consumption of milk in numerous locations, but vending is currently underdeveloped relative to the competition.
- Product perishability limits promotion and display efforts and eliminates retailer and consumer stock-up. BMC believes that higher in-home inventories of beverage products can lead to increased consumption levels. However, new pasteurization and packaging techniques are beginning to create distribution, display and stock-up options. Consumer perception of these products and their "freshness" needs to be modified in order to make them truly viable.

Marketing alignment

- Coordination and alignment between the national program developers, processors and retailers have improved, but integration/alignment must be much tighter before milk can even approach its competition in terms of marketing strength. In well-aligned programs, local activities reference and reinforce the main themes of the national generic advertising.

Pricing

- The milk industry is limited (structurally and legally) in its use of price promotion. Specifically, product perishability as well as state regulations limit the industry's ability to use price promotions.
- Milk's competitive set uses price promotion aggressively to promote consumption and stock-up.

BMC'S ASSESSMENT OF CURRENT MILK MARKETING PROGRAMS

Beverage Marketing believes the marketing campaign under the Dairy Act and the Fluid Milk Act has successfully slowed milk's long historical slide in per capita consumption dating back to 1970, but the downturn in 2000 and 2001 may be evidence of a lagged affect of the decline in milk's advertising spending and share of voice. See **Figure 4-8**. The recent decline in milk's advertising expenditure since 1997 may be a contributing factor to the decline in volume sales.

Advertising expenditure is one very large piece of the total generic milk campaign, and decreases in advertising expenditures have largely been made to increase promotional efforts and various strategic and operational initiatives, such as supporting and encouraging processors to innovate and market their brands, and the further development of school-related programs. These operational initiatives may now be beginning to impact the consumption of milk, but may have enduring affects on milk availability and consumption.

Figure 4-8

Combined Producer/Processor Milk Advertising Spend and Change (Millions of Dollars) 1997-2001

	Total	Change
1997	$187.7	27.9%
1998	$175.2	-6.7%
1999	$158.6	-9.5%
2000	$153.1	-3.5%
2001	$137.7	-10.1%

Source: Beverage Marketing Corp.; Bozell

The "got milk?" campaign has been successful by almost any measure. It has won awards and realized unprecedented awareness levels among all consumer groups. It has given milk an enduring contemporary image with current, trendy celebrity endorsements. It has also allowed for highly targeted advertising in a wide variety of media to a diverse consumer base. The flexibility of the "got milk?" campaign is one of its greatest strengths. This strength will be crucial if the same campaign is to evolve as milk moves strongly into single-serve packaging and new channels.

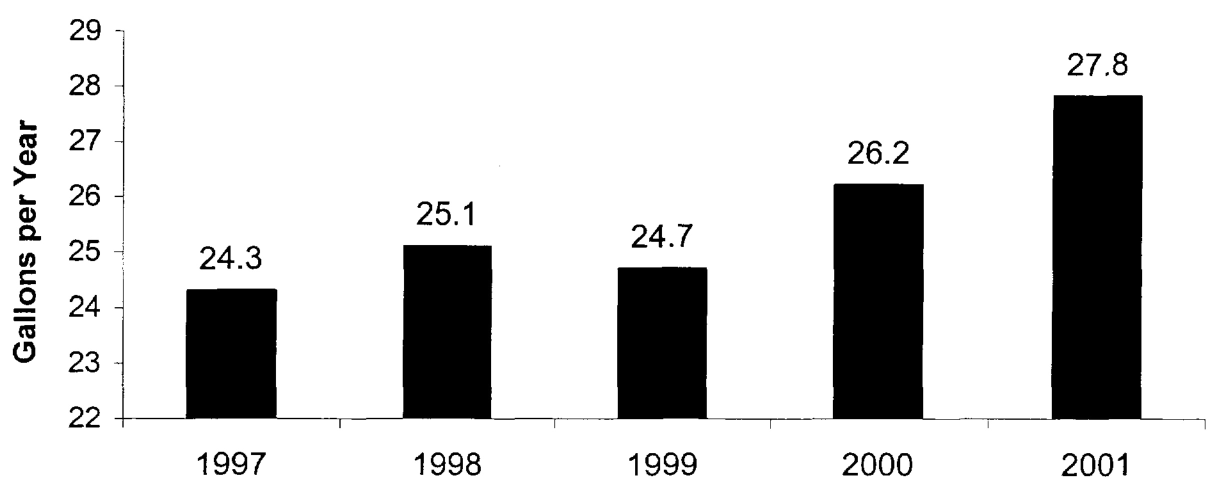
Beverage Marketing believes milk's volume declines would be greater without the national generic program. The milk marketing campaign has effectively defended milk against strong competition and has done so with less advertising spending per gallon than any other segment in the competitive beverage set. However, it is no surprise that milk per capita consumption is shrinking when we consider how it has been competing for consumers. Milk has experienced four consecutive years of decreases in advertising spending while no competitor has had two consecutive years of substantial decreases. Milk's competition is leveraging substantial, steady advertising expenditure for higher share of voice. Bottled water once again had a huge advertising spend increase and spent almost the same amount as milk, in absolute terms, but surpassed milk in spending per gallon.

In line with past Beverage Marketing recommendations, the milk campaign has recently been more focused on key segments likely to drive future industry growth (e.g., flavored milk, Hispanics, kids, and teens), and has reduced efforts against non-core users, including male adults. While total industry performance and two years of significant decline might indicate decreasing effectiveness of the generic industry program, closer examination of consumption trends among some targeted segments suggests that recent, targeted efforts have been quite successful. These improvements are not likely to drive total industry gains over the short-term, but rather will have a significant longer-term impact. This impact will likely accelerate as the industry continues to enhance its growth-segment packaging, products, and availability in a manner that is commensurate with the positioning and imagery of the national program.

The targeted strategy appears to be a powerful tool for increasing milk consumption. The crucial 6-12 year old demographic has shown increases in per capita consumption for two years. In 2001, per capita consumption for children ages 6-12 was 28 gallons of milk, regaining its highest point since 1991, and continuing an upward trend since 1999. See **Figure 4-9**.

Figure 4-9

Per Capita Milk Consumption by Children 6-12
1997-2001

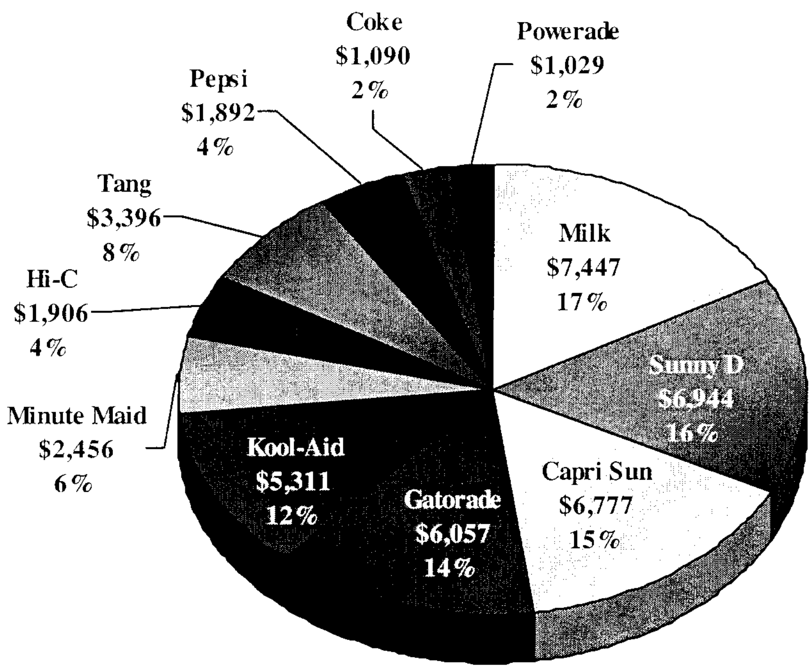


Source: Beverage Marketing Corp.; SIP

In terms of ad dollars spent against the target, milk is the top beverage advertiser in child-focused television, spending nearly $7.5 million in 2001. See **Figure 4-10**. The next closest competitive brand, Sunny Delight, spent just under $7 million. It is important to recognize, however, that this comparison is between a generic industry program and a single brand program. There was no significant kid milk brand advertising expenditures in 2001. Nevertheless, the generic advertising/promotional efforts have helped enable milk to maintain its status as the dominant beverage (37% share of stomach) for 6-12 year olds.

Figure 4-10

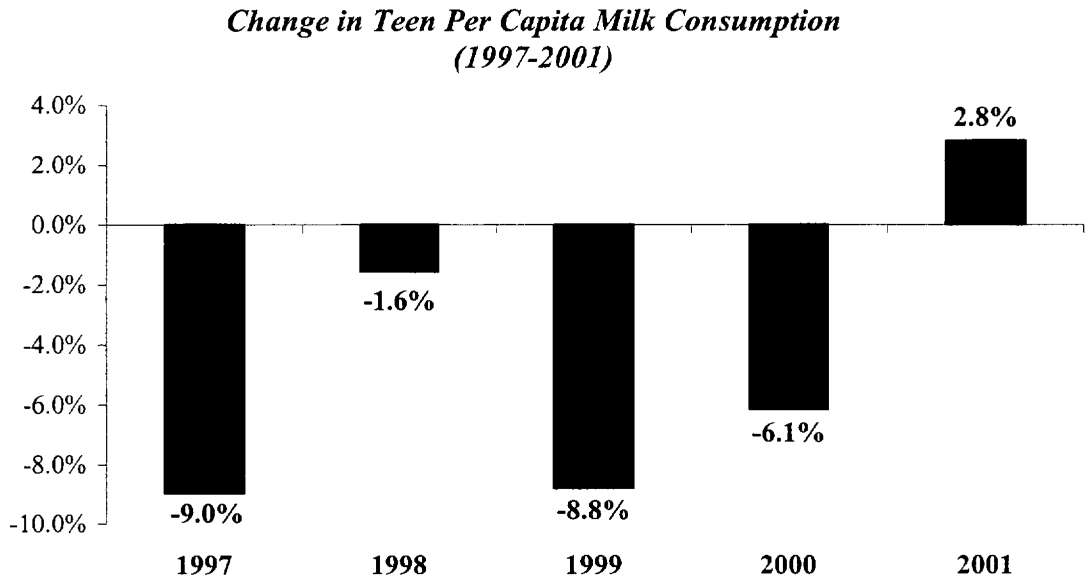
2001 Top Children TV Beverage Advertising Spenders
Share of Voice
(000's of Dollars)



Source: Beverage Marketing Corp.; Bozell; 2001 Ad Views

Similarly, taking a more targeted approach toward teens and shifting the advertising and promotional focus to flavored milk seems to have had a powerful positive affect on milk consumption by teens. In 2001, per capita consumption by 13-17 year olds grew for the first time since 1996 up by 2.8%. See **Figure 4-11**. Between 1997 and 2000, the change in per capita milk consumption by teens averaged -6.4% annually and had a CAGR of -4.2%. In 2001, milk's advertising expenditure targeted at teens increased more than four-fold, from $5.3 million in 2000 to $22.9 million in 2001. Promotions and public relations efforts targeted to teens were also increased as part of the re-focusing of the campaign. Reversing four years of decline and posting a 2.8% gain is a significant accomplishment and seems largely attributable to the strong focus of both advertising and promotional efforts on children and teens, and on flavored milk.

Figure 4-11



Source: Beverage Marketing Corp.; SIP

Milk's gains with the 6–12 year-old and teen cohorts are important because it is at this age that children begin to form life-long brand and product loyalties, as well as life-long eating and drinking habits. Kids and teens have been targeted either directly through media channels, through school programs or through "gatekeepers" like parents who control the options of children. Though still early in the program, the focus on the Hispanic segment is likely also to be successful in increasing milk consumption, by capturing some of the growth in this segment. During 2001, the marketing effort and advertising spend has been better focused on key demographic segments and the results seem to show a distinct positive effect.

Overall, however, milk continues losing consumption share to competitive beverage segments. See **Figure 4-3.** Milk's "healthy" position in the competitive set has been significantly undermined by the aggressive introduction of products and marketing messages in direct challenge to milk. Calcium fortified juices and vitamin enhanced bottled water, fruit drinks, and teas are the most popular examples of this competitive trend. Bottled water is projected by BMC to eclipse milk (as well as coffee and beer) and gain the second highest per capita consumption after carbonated soft drinks by 2004.

This year's total and per capita consumption decreases for milk indicate that milk programs may need some strategic re-thinking. As suggested in last year's report, the messaging must shift to higher-order consumer benefits, as competitors have co-opted the nutritional proposition (mainly calcium) supported by the milk program. As product, package and channel innovations increase the potential usage occasions for milk, an evolution of the campaign may be necessary to fully leverage these new opportunities. There is increasing room for improved demographic and usage occasion segmentation to enhance the efficiency and impact of the campaign. This is essential in an atmosphere of static or decreasing budgets.

The milk program has evolved into a contemporary image-based campaign that still effectively communicates the nutritional benefits of milk. A contemporary image, however, is not in itself differentiating and shifting to a connection between milk's image and higher-order need states such as self-esteem, well-being, and confidence will be crucial for milk in order to compete for consumers' minds and hearts and not just their stomachs.

The positive consumption data reported for the crucial 6-12 year old and teen demographics is evidence of milk successfully targeting younger consumers and their gatekeepers. In addition, the campaign has responded to the need for strong, targeted messaging tailored to specific ethnic groups by tripling Hispanic advertising expenditure. However, generic advertising is at an inherent disadvantage compared to brand advertising. Without developing, marketing and innovating brands, milk will continue to be viewed as a commodity. Once more branded products and marketing programs emerge, coordination will be crucial to maximize the affect of the broad generic milk marketing programs with the targeted marketing of branded milk products.

Milk's advertising expenditures versus its competitive set must be made more competitive. While there is no proven quantitative link between share of advertising expenditures and sales, there is little doubt that the substantial advantage milk's competitors have developed in the volume of their message puts milk at a considerable disadvantage. Small targeted spending increases (generic and branded) can have significant impact and effectively do more with less gross spending.

In 2001, the alignment of milk marketing programs among producers, processors, and retailers improved markedly, but the opportunity is also growing faster now than ever before. The advent of competitive single-serve packages and the introduction of new flavors has increased the need for and the potential effectiveness of promotional events. Participation in marketing and promotional programs by dairy processors was up in 2001. Nevertheless, there are still significant improvements to be made. Further integrating the positioning, packaging, pricing, availability, and public relations efforts along with brand programs will have a positive multiplier affect as each piece of the marketing program further supports all others.

Retail educational programs in the areas of category management and merchandising may also provide valuable synergies between advertising and promotion impact. Milk is not likely to quickly develop executional expertise to rival its competitors in this area, but efforts to improve the merchandising, shelf management, and point-of-sale (POS) capabilities of the milk industry will become increasingly important as the mix of products grows and as milk begins to make inroads into more competitive channels. Programs to train field staff in sales and merchandising are important but equally important is an effort to change the attitude that milk does not need competitive point-of-sale and merchandising.

Once again, innovation remains the key to milk's future growth. New products, packages, flavors, and channels must continue to be developed, brought to market by processors and supported by generic and brand milk marketing programs. Milk has a strong advertising campaign but needs the products and execution to match the messaging.

Moving forward, there are four crucial activities to be carried out to improve milk's position: evolve the marketing message towards higher-order consumer need states, continue to heighten the focus on key demographics/targets, continue to develop and make available new products for more diverse usage occasions, including strong branded products/programs, and maximize distribution through non-traditional channels.